STATE OF COLORADO

DEPARTMENT OF REVENUE

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GIL-12-016

John W. Hickenlooper Governor

> Barbara J. Brohl Executive Director

December 31, 2012

Re: Affiliate Nexus

Dear XXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXXX ("Company") a request for guidance to determine whether Company is presumed to have nexus in local jurisdictions given the affiliate nexus rule.

The Department issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department regulation 24-35-103.5 at www.colorado.gov/revenue/tax > Tax Library > Rulings.

The Department initially treats your request as one of a general information letter. If you would like the Department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with regulation 24-35-103.5. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction.

Issue

- 1. Does the Affiliate Nexus rule filter down to state-administered localities?
- 2. What constitutes a business presence in a local jurisdiction when all Company does is deliver goods? How many deliveries, etc?
- 3. What constitutes a business presence in a local jurisdiction if Company's traveling salespeople visit a customer base? How often, etc?

Background

Company is an industrial distribution company and has multiple subsidiaries, of which at least three have a physical presence in Colorado. The majority of Company's business is conducted at retail or wholesale. Company very rarely installs products. The question at issue is whether the affiliate nexus rule applies to Company.

Discussion

The Department does not make determinations of nexus in general information letters. However, we can provide some general rules regarding nexus.

Colorado imposes sales and use tax on the sale, use, storage, and consumption of tangible personal property ("goods"). An out-of-state retailer must collect sales or use tax for goods sold in Colorado if the retailer is "doing business" in Colorado. "Doing business in this state" is defined in §39-26-102(3), C.R.S. to include the following activities:

- (3) "Doing business in this state" means the selling, leasing, or delivering in this state, or any activity in this state in connection with the selling, leasing, or delivering in this state, of tangible personal property by a retail sale as defined in this section, for use, storage, distribution, or consumption within this state. This term includes, but shall not be limited to, the following acts or methods of transacting business:
 - (a) The maintaining within this state, directly or indirectly or by a subsidiary, of an office, distributing house, salesroom or house, warehouse, or other place of business;
 - (b)
- 1. The soliciting, either by direct representatives, indirect representatives, manufacturers' agents, or by distribution of catalogues or other advertising, or by use of any communication media, or by use of the newspaper, radio, or television advertising media, or by any other means whatsoever, of business from persons residing in this state and by reason thereof receiving orders from, or selling or leasing tangible personal property to, such persons residing in this state for use, consumption, distribution, and storage for use or consumption in this state.
- II. Commencing March 1, 2010, if a retailer that does not collect Colorado sales tax is part of a controlled group

^{1 . §39-26-104} and 202, C.R.S. (sales and use tax apply to the sale, use, storage, or consumption of tangible personal property). You can view this and other statutes, regulations, and department publications by visiting our web site at www.colorado.org/revenue/tax > Tax Library.

2 §39-26-102(3), C.R.S.

of corporations, and that controlled group has a component member that is a retailer with physical presence in this state, the retailer that does not collect Colorado sales tax is presumed to be doing business in this state. For purposes of this subparagraph (II), "controlled group of corporations" has the same meaning as set forth in section 1563(a) of the federal "Internal Revenue Code of 1986", as amended, and "component member" has the same meaning as set forth in section 1563(b) of the federal "Internal Revenue Code of 1986", as amended. This presumption may be rebutted by proof that during the calendar year in question, the component member that is a retailer with physical presence in this state did not engage in any constitutionally sufficient solicitation in this state on behalf of the retailer that does not collect Colorado sales tax:

Colorado presumes that out-of-state retailers who are conducting business in Colorado are doing business in Colorado when a related or affiliated retailer has a physical presence in Colorado. Nexus is established by the out-of-state retailer who is part of a "controlled group of corporations" that has a member with a physical presence in Colorado.³

26 U.S.C. (1986) §1563(a) defines a "controlled group of corporations" as:

- (1) Parent-subsidiary controlled group
 One or more chains of corporations connected through stock
 ownership with a common parent corporation if
 - (A) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned by one or more of the other corporations; and
 - (B) the common parent corporation owns stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.
- (2) Brother-sister controlled group

^{3 §39-26-102(3)(}b)(II), C.R.S.

Power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock of each corporation, taking into account the stock ownership of each such person only to the extent such stock ownership is identical with respect to each such corporation.

- (3) Combined group
 - Three or more corporations each of which is a member of a group of corporations described in paragraph (1) or (2), and one of which:
 - (A) is a common parent corporation included in a group of corporations described in paragraph (1), and also
 - (B) is included in a group of corporations described in paragraph (2).

A "component member" is defined in §1563(b) as follows:

- (1) General rule. For purposes of this part, a corporation is a component member of a controlled group of corporations on a December 31 of any taxable year (and with respect to the taxable year which includes such December 31) if such corporation—
 - (A) is a member of such controlled group of corporations on the December 31 included in such year and is not treated as an excluded member under paragraph (2), or
 - (B) is not a member of such controlled group of corporations on the December 31 included in such year but is treated as an additional member under paragraph (3).
- (2) Excluded members. A corporation which is a member of a controlled group of corporations on December 31 of any taxable year shall be treated as an excluded member of such group for the taxable year including such December 31 if such corporation—
 - (A) is a member of such group for less than one-half the number of days in such taxable year which precede such December 31,
 - (B) is exempt from taxation under section 501 (a) (except a corporation which is subject to tax on its unrelated business taxable income under section 511) for such taxable year,
 - (C) is a foreign corporation subject to tax under section 881 for such taxable year,
 - (D) is an insurance company subject to taxation under section 801 (other than an insurance company which is a member of a controlled group described in subsection (a)(4)), or
 - (E) is a franchised corporation, as defined in subsection (f)(4).
- (3) Additional members. A corporation which—
 - (A) was a member of a controlled group of corporations at any time during a calendar year,
 - (B) is not a member of such group on December 31 of such calendar year, and
 - (C) is not described, with respect to such group, in subparagraph (B),
 (C), (D), or (E) of paragraph (2), shall be treated as an additional member of such group on December 31 for its taxable year including

such December 31 if it was a member of such group for one-half (or more) of the number of days in such taxable year which precede such December 31.

(4) Overlapping groups. If a corporation is a component member of more than one controlled group of corporations with respect to any taxable year, such corporation shall be treated as a component member of only one controlled group. The determination as to the group of which such corporation is a component member shall be made under regulations prescribed by the Secretary which are consistent with the purposes of this part.

In sum, if your Company is a component member of a controlled group of corporations and the controlled group contains a retailer with a physical presence in Colorado, then the Company is presumed to be doing business in Colorado at a level sufficient to require the collection of Colorado sales tax.⁴

The Department administers the sales taxes and, in some cases, use taxes of state-administered cities, towns, counties, and special districts. Section 29-2-106, C.R.S. directs the Department to administer local taxes consistent with statutes governing the administration of state taxes. Affiliate nexus rules discussed above also apply to state-administered local jurisdictions. For example, if one of Company's subsidiaries has nexus in a Colorado city and county and has affiliated nexus at the state level, this will create affiliated nexus for Company in that particular city and county.

The Department has issued a variety of informational material on local taxes. In FYI Sales 62, ("Guidelines for Determining When to Collect State-Collected Local Sales Tax"), the Department sets forth general guidance regarding the application of local sales and use taxes.

If, however, neither the taxpayer nor any affiliate is located in a local jurisdiction, then the question is whether the any affiliate has sufficient business presence in a local jurisdiction to obligate Company to collect and remit sales and use tax. There are at least two issues when considering local sales taxes: (1) where does the sale occur and (2) does the retailer have a business presence in the local jurisdiction into which the goods are delivered to allow that destination jurisdiction to require the retailer to collect its local tax.

With respect to the first issue, a sale occurs where title or possession passes to the purchaser. In most cases, title passes with change of possession. When a retailer delivers by common carrier or by its own vehicle goods to the buyer at a location outside the boundaries of the retailer's local jurisdiction, then the retailer does not collect the state-

For a list of local jurisdictions levying these taxes, see Department publication 1002. You can view this publication on the Department's web site at www.colorado.gov/revenue/tax > Forms > Forms by Number > DR 1002. The Department does not administer the sales and use taxes of home-rule cities and counties.

⁴ §39-26-102.3(3)(a).

⁶ Leggett & Platt, Inc., The Gap, Inc. v. Maria Ostrom, in her official capacity as Interim Finance Director and City Treasurer of the City of Thornton, 09 Colorado Court of Appeals, 1322; 09CA2181, 09/30/2010 ⁷ Leggett & Pratt, supra.

administered local sales or use taxes in which it is located. However, if the retailer has a business presence in the other local jurisdiction, then it must collect sales tax of that other jurisdiction.

There is no statute or Department publication that describes in detail what activities create a business presence in another local jurisdiction. In Associated Dry Goods Corporation, d/b/a/ The Denver Dry Goods Company, a Virginia corporation v. City of Arvada, Colorado, a municipal corporation, Don M. Harwell, and S. W. Tanner, 197 Colo.491 593 P2d 1375, (05/07/1979),⁸ the court held that if a retailer occasionally delivers its product by common carrier or by its own vehicles into another local jurisdiction and the retailer has no other contact with the local jurisdiction, then Company does not have sufficient connection with that jurisdiction to create a business presence to require the collection of its local sales or use taxes. FYI Sales 62 states that the retailer must have some significant presence in the destination jurisdiction in order for that jurisdiction to have the authority to require the retailer collect its taxes. In pertinent part, FYI 62 states,

Deliveries of Goods

Local sales taxes and Regional Transportation District/Cultural and Scientific Facilities District/Metropolitan Football Stadium District (RTD/CD/FD) taxes are not collected when the retailer or his agent delivers tangible personal property, via the retailer's vehicle, to a destination outside the boundaries of the vendor's local taxing jurisdiction(s) or to a common carrier for delivery outside the boundaries of the vendor's local taxing area(s). Delivery of the tangible personal property into another local taxing area does not require the vendor to collect the local sales taxes of the delivery area if the vendor does not have a business presence there. However, sold goods that are turned over to a contractor/subcontractor or other agent who is not primarily a common carrier for delivery outside the local taxing jurisdiction (for example, a carpet store turning over sold carpet to an independent installer who then installs the carpet for the purchaser), does not constitute delivery to another taxing area under this rule. The goods are taxable in the local jurisdiction where the contractor/subcontractor picks up the goods.

However, if Company engages in more than occasional deliveries into a local tax jurisdiction, then its activities may create a business presence. For example, a sustained presence of Company employees in a local tax jurisdiction will create a business presence in that tax jurisdiction. A sustained employee could include either a direct representatives (Company's salesperson), indirect representatives (affiliated

⁸ Associated Dry Goods was decided in 1979 and places substantial reliance on Miller Bros for its analysis of Constitutional nexus issues. Constitutional law regarding sales tax nexus has significantly changed since the decision in Associated Dry Goods. It is generally recognized that the Commerce Clause analysis announced in Miller Bros and relied on in Associated Dry Goods has been largely overturned. Nevertheless, the department continues to believe that a retailer must have something more than a di minimis contact with a local jurisdiction before the local jurisdiction can require the retailer to collect that jurisdiction's tax.

company's employees), manufacturers' agents or any other means whatsoever where Company routinely solicits orders from, or selling or leasing tangible personal property to, people residing in Colorado for use, consumption, distribution, and storage in Colorado. If this is the case, the Department will generally assert that the retailer has a sufficient presence to be required to collect the sales taxes of the local tax jurisdiction regardless of whether a business delivers the goods with their own vehicles or contracts a third party to do so.

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

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